5/8/81

Financial Markets

Irving Trust

Irving Trust Company
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New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

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As anticipated here last Friday, the Treasury's three refunding auctions easily set record yields, while the rate on Federal funds worked down from its distortedly high level of the week before. Nevertheless, the Federal Reserve made its intentions clear to the market on Monday by raising its discount rate to a record 14% and increasing the surcharge on loans to large frequent borrowers to 4%.

The contrast between the refunding and the auction of the 2-year notes on April 22 was not so much the yield levels--they were all very high--but the excellent bidding for the refunding issues. The Treasury received $9.6 billion in tenders for the $3 billion of 3-year notes offered, $4.5 billion tenders for the $1.75 billion of 10-year notes, and $5.0 billion tenders for the $2 billion of 30-year bonds. That was quite a turnaround from the meager $5.2 billion of tenders received for the $4.25 billion of 2-year notes. The record high yields accounted for it, together with a fairly widespread feeling among market participants that those yields might decline soon.

There are a number of reasons why such might occur. Thursday's impressive House vote on the Reagan Administration's proposed budget is one such factor. Moreover, the Federal Reserve should make an outright purchase of securities, quite possibly coupons, before long. That would be a seasonal operation, of course, but it would alleviate the inventory positions of dealers and improve the technical condition of the market somewhat.

To an extraordinary degree, however, rates in the short-term sector currently are keying off of movements in the Federal funds rate, and the immediate prospect is for increasing firmness in that rate. The Fed's execution of four-day reverse RPs on Thursday and three-day RPs today when funds were trading a bit above 18% appears to have been designed to insure that pressure on banks will continue to be severe and may even intensify. In that setting, a further upward adjustment of the prime rate is a near-term probability.

Meanwhile, though signs of economic sluggishness abound, money stock growth is strong. Much discussion recently has focused on the formidable problems of seasonal adjustment of the monetary aggregates during April, when changes in tax payment behavior can distort growth markedly. On balance, however, these technical problems do not appear to account for much if any of the recent strength of M-1B. Rather, it appears that the acceleration reflects a not unusual "catch-up" of money growth relative to income following the first quarter, when nominal GNP is estimated to have grown at a strong 14.9% rate, while M-1B rose only at a 6.6% rate, despite being lifted artificially by inflows into NOWs from savings-type accounts. If that is the case, one should expect money growth to continue strong for a while at least, with a correspondingly tight policy stance on the part of the Fed. Also, the FOMC's judgment in the February-March period to resist declines in interest rates would appear to have been qualitatively better than the advice being offered the Committee at the time by the Treasury. Small wonder that the credibility of the Fed is on the build.

William C. Melton

Note: The full text of the letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

Irving Trust

Market Yields

	5/8/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	19.00%	18.00%	17.50%
Effective since	5/4/81		
Discount Rate at Federal Reserve Bank	14.00	13.00	13.00
Federal Funds	18.00	19.75	10.63
Repurchase Agreements	17.50	17.00	8.25
U.S. Treasury Issues			
Bills			
3 months	17.38	15.69	9.22
6 months	17.01	15.48	9.56
1 year	16.39	15.14	9.89
Coupons			
2 years	15.63	14.76	9.79
4 years	15.09	14.45	9.95
7 years	14.42	14.21	10.37
10 years	14.20	14.08	10.41
Long Bond	13.75	13.58	10.44
Negotiable Certificates of Deposit-Secondary Market			
1 month	18.80	16.80	10.25
3 months	18.85	16.75	10.25
6 months	18.20	16.45	10.20
1 year	17.20	16.00	10.20
Banker's Acceptances			
1 month	18.40	16.80	9.95
3 months	18.75	16.75	10.00
6 months	18.15	16.50	10.10
Eurodollar Deposits			
1 month	19.25	17.63	10.88
2 months	19.38	17.50	11.38
3 months	19.50	17.25	11.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	18.00	17.00	7.00
1 month	17.50	15.00	9.00
3 months	16.75	15.00	9.25
Bank Holding Companies			
1 month	18.50	16.50	9.38
Dealer Placed:			
3 months	18.00	16.00	9.50
New AA Corporate Utility Bond	16.35	16.50	12.00
Tax Exempt			
6 month Project Notes	7.65	7.80	5.25
1 year AAA Bond	7.80	7.40	5.40
5 year AAA Bond	8.50	8.45	5.35
20 year AAA Bond	10.00	10.20	6.10

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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